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December 16, 2003

VIA HAND DELIVERY

Marlene H. Dortch, Esq
Secretary
Federal Communications Commission
445 12th Street, SW, Room 8B201
Washington, DC 20554

Re Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers
WC Docket No. 03-173
Comments of Cox Communications, Inc.

Dear Ms Dortch

Please accept this letter as the comments of Cox Communications, Inc. ("Cox") in the above-referenced proceeding [1]

A leading competitive local exchange carrier ("CLEC"), Cox provides facilities-based local telephone service to roughly one million residential customers and more than 100,000 business customers. In eleven markets, Cox's telephone service is circuit-switched; in its twelfth market, launched just this week, Cox is using Voice over Internet Protocol ("VoIP") technology. Cox began providing local telephone service over its upgraded cable networks in 1997. Six years later, it is one of the largest and most experienced facilities-based carriers to provide local residential telephony services in direct competition with the services offered by incumbent local exchange carriers ("ILECs").

Cox is interested in this proceeding because it shares the Commission's concern that the current pricing structure for unbundled network elements ("UNEs") may not serve the critical statutory goal of promoting the deployment of facilities-based local telephone competition. Although Cox has met with considerable success rolling out local phone service over its advanced cable infrastructure, it often finds in its markets that it is the only fully facilities-based competitor to the ILEC (other than wireless carriers) offering residential phone service. As Cox has long urged[2] and the Commission has long recognized, however, only facilities-based

[1] Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers, *Notice of Proposed Rulemaking,* WC Docket No 03-173, FCC 03-224, rel Sep 15, 2003 (the "*Notice*")

[2] *See*, e g , CC Docket No 96-98, Cox Comments, May 16, 1996, at 6-9

competition provides the optimum consumer benefits and is sustainable in the long run. As the Commission explained in 1999:

> [W]e believe that, in the long term, the most substantial benefits to consumers will be achieved through facilities-based competition, because only facilities-based competitors can break down the incumbent LECs' bottleneck control over local networks and provide services without having to rely on their rivals for critical components of their offerings. Moreover, only facilities-based competition can fully unleash competing providers' abilities and incentives to innovate, both technologically and in service development, packaging, and pricing.[3]

The Commission confirmed this analysis in the 1999 *UNE Remand Order,* stating that "the unbundling rules we adopt in this proceeding seek to promote the development of facilities-based competition" and, most recently, in the *Triennial Review Order,* which "reaffirm[ed] the conclusion in the *UNE Remand Order* that facilities-based competition serves the Act's overall goals "[4]

In Cox's view, the Commission could better ensure that local telephone markets receive appropriate investment signals by modifying its approach to setting UNE rates. Under the Commission's current regime, the rates for both UNEs and reciprocal compensation are set using the TELRIC methodology. As a result, CLECs receive the same investment signal when they lease UNEs that they do when they construct their facilities and simply exchange traffic with the ILEC pursuant to reciprocal compensation

Simply put, this pricing scheme provides little or no incentive to CLECs to invest in local telephone infrastructure. Facilities-based CLECs that do invest find themselves competing with other CLECs that are merely reselling, at low rates, the physical plant deployed by the ILEC. Such facilities-based competitors also receive no regulatory benefit under the current pricing structure when they launch service over their own networks and merely exchange traffic with ILECs, because the prices for reciprocal compensation are set using the same methodology that is used to set rates for UNEs. If the Commission seeks to establish a rate-setting approach that encourages CLECs to build out their networks, to reduce their reliance on the ILECs' infrastructure, and to exchange traffic as co-carriers, it must re-evaluate the wisdom of using the same methodology for setting UNE and reciprocal compensation rates

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[3] Promotion of Competitive Networks in Local Telecommunications Markets, *Notice of Proposed Rulemaking and Notice of Inquiry,* WT Docket No 99-217 and CC Docket No 96-98, FCC 99-141 (rel July 7, 1999) ¶¶ 4 (footnotes omitted), 23

[4] Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, *Third Report and Order and Fourth Further Notice of Proposed Rulemaking,* 15 FCC Rcd 3696, 3701 (1999) *reversed and remanded in part sub nom United States Telecom Ass'n v FCC,* 290 F.3d 415 (D C Cir 2002) (*"UNE Remand Order"*), Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, *Report and Order on Remand and Further Notice of Proposed Rulemaking,* CC Docket No 01-338 et al., FCC 03-36 (rel Aug. 21, 2003) (*"Triennial Review Order"*), ¶ 70, *see also UNE Remand Order,* 15 FCC Rcd at 3704 ("[U]nbundling rules that are based on a preference for development of facilities-based competition in the long run will provide incentives for both incumbents and competitors to invest and innovate, and should allow the Commission to reduce regulation once true facilities-based competition develops ")

An alternative approach, first suggested by Cox in its comments in the Commission's original local telephone competition proceeding,[5] would correct the investment signals being sent to the telecommunications market and would promote greater deployment of local telephone facilities. Under Cox's proposed approach, UNE rates would be set using one pricing methodology and reciprocal compensation rates would be set using a distinct methodology. In particular, states would be permitted to set UNE rates in a range from total service long run incremental cost to fully distributed cost By contrast, states would set reciprocal compensation rates in a range from bill and keep to forward-looking long run incremental cost

Such a "two-tiered" pricing approach is completely consistent with the local telephone competition provisions of the 1996 Act. Indeed, both the structure and the specific language of the Section 252(d) are consistent with the conclusion that Congress intended for the Commission to adopt different pricing rules for UNEs and reciprocal compensation. The structural element is clear: There are separate provisions governing UNE and reciprocal compensation rates. In light of this structure, the most reasonable conclusion is that Congress enacted these separate provisions because the rates were intended to be determined independently.[6] This conclusion, moreover, is reinforced by the text of Section 252(d), which plainly adopts two different rate-setting standards Section 252(d)(1), which governs UNEs, requires state commissions to set rates "based on the cost" of providing those elements, and permits "a reasonable profit" to be included in those rates 47 U S.C § 252(d)(1) Section 252(d)(2), however, limits carriers' recovery for reciprocal compensation to "the additional costs of terminating such calls." 47 U S C § 252(d)(2) In short, the 1996 Act itself supports an approach that distinguishes between the methodologies used to set UNE and reciprocal compensation rates.

The decoupling of reciprocal compensation and UNE prices using the Cox model also would have significant benefits beyond correcting investment incentives in local telephone markets. First, because it sets forth a range of acceptable rates, the model would give the states flexibility to respond to local concerns and to consider their own particular circumstances, such as state-specific costs and the extent to which competition in a particular market may be more or less sensitive to UNE rates. Second, the model would address many of the concerns relating to reciprocal compensation rates that have been the subject of extensive Commission proceedings.[7] The range Cox proposes, with a ceiling set by long run incremental cost, keeps reciprocal compensation rates from being so high that they distort competitive incentives. This has not been the case with TELRIC-based reciprocal compensation rates, which have led to accusations

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[5] Excerpts from Cox's previous filings are attached to these comments as Exhibit 1 and Exhibit 2. These exhibits describe the Cox proposal and the analysis that supports it in more detail While Cox recognizes that some of the specific proposals in the initial model no longer may be appropriate (notably the recommended floor for UNE rates may be too low), the basic structure addresses many of significant issues facing the Commission today.

[6] *See, e g , I N S v Cardoza-Fonseca,* 480 U S 421, 430-2 (1987 (where Congress adopts two different standards for agency conduct, especially when it does so in a single legislative enactment, the agency may not treat the two standards as having the same meaning)]

[7] *See, e g ,* Developing a Unified Intercarrier Compensation Regime, *Notice of Proposed Rulemaking,* 16 FCC Rcd 9610 (2001), Intercarrier Compensation for ISP-Bound Traffic, *Order on Remand and Report and Order,* 16 FCC Rcd 9151 (2001), *remanded WorldCom, Inc v FCC,* 288 F 3d 429 (D C Cir 2002).

that carriers have designed business plans around obtaining terminating traffic.[8] Indeed, with long run incremental cost as the ceiling, there is a significant likelihood that more carriers will seek bill and keep arrangements, because the cost of billing for reciprocal compensation will become a relatively large fraction of the net revenue a carrier could obtain.

For the foregoing reasons, Cox respectfully requests that the Commission modify its rules to permit states to set UNE rates in a range from total service long run incremental cost to fully distributed cost, and to set reciprocal compensation rates in a range from bill and keep to forward-looking long run incremental cost This approach will more faithfully implement Congress' desire to promote sustainable, facilities-based competition in local telephone markets

Respectfully submitted,

J G. Harrington

Counsel to Cox Communications, Inc

JGH/vll

cc: Chairman Michael K Powell
Commissioner Kathleen Q. Abernathy
Commissioner Michael J. Copps
Commission Kevin J. Martin
Commissioner Jonathan S. Adelstein
Chief, Pricing Policy Division, Wireline Competition Bureau (2 copies)

[8] As Cox has noted in other contexts, claims that CLECs have distorted the marketplace by seeking to terminate traffic are somewhat ironic in light of the strenuous efforts of ILECs to obtain higher reciprocal compensation rates in the initial local competition proceedings

EXHIBIT 1

STAMP & RETURN

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

MAY 16 1996

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
	)	

To: The Commission

COMMENTS OF COX COMMUNICATIONS, INC.

Werner K. Hartenberger
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May 16, 1996

Clearly defined standards also will make it easier for the States to fulfill their substantial obligations under the 1996 Act If interconnecting carriers and the States are given clear, consistent bounds on the range of acceptable outcomes in interconnection negotiations, they will be better able respectively to reach agreements, direct arbitrations and adjudicate disputes. Such outcomes will fulfill the Congressional mandate to benefit "all Americans by opening all telecommunications markets to competition[.]"[23/]

II. THE COMMISSION SHOULD ESTABLISH SEPARATE BOUNDARIES FOR EACH OF THE THREE DISTINCT PRICE/COST STANDARDS FOR LOCAL SERVICE OPTIONS CREATED BY CONGRESS IN THE 1996 ACT. (Notice Sections II.B. and C and Section III.)

In establishing policies to promote competition for local exchange services, Congress recognized that new competitors will have different strategies for entering the local exchange market and that the success of these strategies will depend, in whole or in part, on the terms under which facilities or services are obtained from incumbent LECs.[24/] Consequently, to facilitate entry by a broad range and number of competitors, Congress recognized three distinct methods new entrants might use to provide competitive local exchange service: entry via resale, entry via purchase of unbundled elements and entry by the operation of a facilities-based network.

These distinct local service options are governed by equally distinct cost standards. For consumers to reap the maximum benefits from competition as Congress intended, the

23/ Conference Report at 1.

24/ This same recognition is reflected in the Notice at ¶ 9. ("Different entrants may be expected to pursue different strategies that reflect their competitive advantages in the markets they seek to target.")

Commission must establish clear, differentiated allowable cost boundaries for the services or functions delivered by incumbent LECs to their local competitors. These boundaries should reflect the differing costing standards that Congress adopted and should not permit overlap between the cost standards for unbundled elements and the standards for reciprocal transport and termination Within the bounds established by the Commission, the States can then meet their historic responsibility to determine appropriate costs for specific unbundled elements or for reciprocal transport and termination, provided that their determinations do not exceed the bounds set by the Commission. If, as the Commission has suggested, a strong national framework governing the costs the incumbent can pass onto competing carriers is established, then the promise of the 1996 Act will be fulfilled.

A. Congress Established Three Local Service Options for New Competitors in the 1996 Act. (Notice Sections II.B and C.)

The introduction of competition into the local exchange market is a monumental task. Incumbent LECs have been building ubiquitous local exchange networks for the past century, charging rate of return guaranteed rates and using those telephone ratepayer revenues to fund a massive infrastructure of interconnected loop, switch and transport facilities. Competing local networks will not take another 100 years to develop, but they will not develop overnight. As the Notice explains, Congress recognized that pervasive and sustainable facilities-based competition is the best way to break the incumbent LECs' stranglehold over the local exchange market, but also decided that consumers should not be denied the benefits of competition while new entrants are building competitive networks.[25/] Consequently, in

25/ Notice at ¶ 75

addition to facilities-based competition, Congress established two alternative ways in which a new entrant in the local exchange market can choose to provide service to a customer — by using unbundled elements of the incumbent's network or through resale of the incumbent's local telephone service.

Congress also recognized that no matter how a competitor chooses to enter the market, it must depend in some way on obtaining services or facilities from the incumbent LEC.[26/] The level of dependence on the incumbent LEC will vary. At one end will be nearly total dependence on resale of the incumbent LEC's residential services. At a middle ground will be dependence on the incumbent LEC to provide for purchase certain unbundled elements At the other end will be a co-carrier or peer relationship of local networks that must meet to exchange traffic to be terminated to the other network's end user customers. A single carrier may provide service through any combination of these approaches at any given time, depending on the mix of facilities it deploys, the services it provides and the customers it serves.

For each of these situations, Congress established a corresponding set of obligations on incumbent LECs and, in some cases, on competitive LECs. How these obligations are translated from the statute books to the market will determine how quickly the potential for competition in the local exchange market is realized. A translation that throws all incumbent LEC services and facilities into the same pricing standard dims the prospect of real facilities-

26/ See id. at ¶ 7 ("It is unlikely that competitors will have a fully redundant network in place when they initially offer local service, because the investment necessary is so significant").

based local competition. A translation that is faithful to the intent of Congress, as evidenced in the statute itself, will advance the prospects for facilities-based competition.

While the 1996 Act does not dictate how a new entrant will choose to enter the local telecommunications market, it does prefer that competitors serve end users by building out at least some of their own local facilities, rather than exclusively reselling the incumbent LEC's services This preference is easily understood in the framework of the 1996 Act: the need to price regulate incumbent LECs is diminished and may disappear over the long term once real, sustainable and facilities-based local competition breaks out. For that reason, the FCC should approach its implementation of the Sections 251 and 252 with great sensitivity to Congressional intent.

1 Facilities-based service. Some new entrants will be able to originate and terminate calls to and from a customer solely over their own facilities, just as incumbent LECs do today. In a competitive market, however, local calls may originate on the network of one carrier and terminate on the network of another carrier. Thus, for a customer of a new entrant to be able to call any other customer in a new entrant's service area, the new entrant must be assured that the incumbent LEC will terminate calls to its customers that originate on the new entrant's network. Without some form of reasonable reciprocal traffic termination arrangement, new entrants would be relegated to niche markets.

FACILITIES-BASED SERVICE

- Entitled to reciprocal transport and termination
- No other charges for interconnection of networks

Congress recognized the importance of mutual and reciprocal traffic termination and transport agreements to the development of facilities-based competition in Section 251(b)(5), which requires that all LECs "establish reciprocal compensation arrangements for the transport and termination of telecommunications."[27] Cox supports the Commission's conclusion that reciprocal compensation for the transport and termination of traffic is the key to developing the seamless network of networks envisioned by the 1996 Act.[28] Through reciprocal compensation arrangements for the mutual exchange of traffic, a customer will be able to make or receive calls to or from any other customer in its carrier's service area even if the other party uses a different local carrier

The reciprocal compensation requirement recognizes that the relationship between competing local exchange providers is a co-carrier, peer network relationship. As described more fully below, Section 251(b)(5) covers the entire transaction between carriers that exchange local traffic. The statute does not contemplate the incumbent LEC collecting a separate "interconnection charge" from peer networks, or for that matter any other kind of additional charge beyond the mandated mutual and reciprocal compensation for transport and termination. Typically, transport and termination interconnection would occur at midspan and meet points where the interconnecting parties share their proportionate cost of meeting.

27/ 47 U.S.C. § 251(b)(5).

28/ Notice at ¶ 6.

2. Service provided using unbundled elements. While some new entrants will choose to provide service over their own facilities, other competitors will not immediately want to build their own facilities to originate or terminate calls to or from the customers they seek to serve. They will need interconnection to and use of network elements of the incumbent LEC. To facilitate the rapid entry of new competitors (who may be in the process of building their own networks or who may have some, but not all the elements they need to serve local customers), the 1996 Act requires incumbent LECs to interconnect with these carriers and to offer their network elements on an unbundled basis.

UNBUNDLED ELEMENTS

- Used to complete a network
- Completed network entitled to reciprocal transport and termination under § 251(b)(5)

Specifically, under Section 251(c)(2), incumbent LECs are obligated to provide "interconnection with the local exchange carrier's network."[29] This interconnection must be made available at any technically feasible point in the LEC's network, must be equal in quality to that which the LEC provides itself and must be provided on rates, terms and conditions that are just, reasonable and nondiscriminatory. In addition, Section 251(c)(3) imposes on incumbent LECs the duty to provide "nondiscriminatory access to network elements on an unbundled basis . . . on rates, terms and conditions that are just, reasonable and nondiscriminatory."[30]

29/ 47 U.S.C. § 251(c)(2).

30/ 47 U S.C. § 251(c)(3).

The intent of these provisions is to permit a new competitor to purchase only those elements of the incumbent LEC's network it needs to complement its existing facilities to create end-to-end networks.[31/] For example, a CAP that seeks to provide local service to residential customers in areas where it does not have facilities can buy local loop facilities from the incumbent LEC. It would not also have to purchase switching, if switching was not an element that it required from the LEC. Congress recognized that absent an unbundling requirement incumbent LECs would require potential competitors to pay for more service than they need, thereby limiting the value of interconnection and reducing the potential for competition. Requiring that elements of the incumbent's network be made available on an unbundled basis will make it more feasible for a new entrant to provide service using a mix of its own facilities and the incumbent's facilities.[32/] Once these networks have the ability to provide end-to-end service locally, competitors that purchase unbundled elements to complete their networks or network functionality are entitled, as described below, to the benefits of Section 251(b)(5) and 252(d)(2) for the exchange of traffic with other local carriers.

31/ Notice at ¶ 75 ("Together, sections 251(c)(3) and 251(d)(2) foster competition by ensuring that new entrants wishing to compete with incumbent LECs can purchase access to those network elements that they do not possess, without paying for elements that they do not require.")

32/ Cox suggests five major categories as a minimum baseline for unbundled elements: Loops, Switching Elements, Transport Elements, Signalling Elements and Ancillary Systems.

3 Resale of service Although Congress expressed a preference for facilities-based competition, it recognized that some new entrants would compete in the local market by reselling the local exchange services of other carriers, particularly the incumbent LEC's services. The availability of this resale option facilitates rapid entry by new competitors in the local market, including facilities-based competitors seeking to expand their service area outside the range of their facilities.[33]

RESALE

- Discounts from retail price only if purchased from incumbent LEC
- Transport and termination included in price
- No right to collect access charges

Section 251(b)(1) requires all local exchange carriers to permit their retail services to be resold. In addition, incumbent LECs are required to make services available for resale at "wholesale" rates under Section 251(c)(4). The purpose of this additional wholesale rate requirement for incumbent LECs is to counter their incentive to price services for resale at a level that eliminates any potential for a reseller to make a profit reselling local service. Unlike carriers in markets with a number of competing networks, where each has an incentive to increase the traffic on its network by offering attractive resale rates, an incumbent LEC can effectively avoid competition by offering resale at unattractive rates because there will not be another facilities-based carrier from which the reseller can buy local exchange service.[34] This will be particularly true in the early stages of competition,

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33/ See Notice at ¶ 10.

34/ For this reason, there also is no need to impose wholesale pricing requirements on non-incumbent LECs. Non-incumbent LECs will be unable to avoid competition and are likely to welcome the additional traffic resellers can provide.

when competitors are just beginning to build competing networks and may be relying heavily on resale to enter the market.

Resellers will purchase retail services from LECs. They will not need to purchase transport and termination because that function already is included in retail telephone service. As the Notice recognizes, they also will not be entitled to collect access charges for interexchange services because those charges are levied separately on interexchange carriers and are not included in retail prices.[35]

35/ Notice at ¶ 186.

The relationship among carriers that operate using one or all these alternatives can be summarized in a simple matrix.[36/]

IF A CARRIER SERVES AN END USER

	ENTIRELY VIA ITS OWN FACILITIES	VIA UNBUNDLED ELEMENTS	VIA RESALE
TRANSPORT AND TERMINATION	Obtains transport and termination under § 251(d)(2) cost standards, bounded on one side by long run incremental cost and on the other by bill and keep		Depends on transport and termination arrangements of the underlying carrier
UNBUNDLED ELEMENTS	Is not required to purchase any unbundled elements or any separate "interconnection" element	Purchases unbundled elements under § 252(d)(1) cost standards, bounded on one side by TSLRIC and on the other by FDC	Does not purchase any unbundled elements
ACCESS (Note 1)	Is entitled to access charges for interexchange traffic that uses its network (Note 2)		Does not receive access charges because it did not purchase the right to obtain them

Note 1 This analysis is based on the current access regime Cox makes no assumptions regarding the outcome of the Commission's proposed access reform proceeding See, e g., Notice at ¶ 165

Note 2 This also would apply when traffic to a carrier's customers is routed to the carrier via interim number portability arrangements such as remote call forwarding In such instances, the carrier that actually terminates the call should receive the access charges, not the carrier that forwards the call

36/ A more detailed matrix of these relationships is attached to these comments as Exhibit 1.

B. The Commission Should Establish Pricing Boundaries for Each of the Three Market Entry Alternatives Contemplated by Congress.
(Notice Section II and Section III.)

In addition to imposing interconnection obligations necessary to promote the three alternatives for the provision of competitive local exchange service, Congress also established three distinct standards to govern the pricing or cost of services and facilities obtained from incumbent LECs under these alternatives. The Commission's interpretation of the 1996 Act in this proceeding must reflect the critical distinctions reflected in these standards. The Commission is required to do so under basic principles of statutory construction. Moreover, adopting differentiated cost standards is the best way to effectuate the direct preference for the development of facilities-based competition underlying the 1996 Act.

The cost standards established by Congress are contained in Section 252(d) of the 1996 Act. Specifically, Section 252(d)(3) requires incumbent LECs to offer services for resale at wholesale rates determined on the basis of retail rates less any avoided costs, such as marketing, billing and collection.[37/] Section 252(d)(1) provides that the incumbent LEC price for interconnection of facilities and for unbundled network elements must be "based on the cost of providing the interconnection or network element" and "may include a reasonable profit."[38/] Finally, Section 252(d)(2) states that the rate for mutual exchange of traffic under a reciprocal compensation arrangement must provide for "the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on

37/ 47 U S.C. § 252(d)(3)

38/ 47 U.S.C. § 252(d)(1).

each carrier's network facilities of calls that originate on the network facilities of the other carrier" at a rate based on a "reasonable approximation of the additional cost of terminating such calls," which includes bill and keep arrangements [39/]

In establishing the Section 252 pricing/cost standards, Congress made clear that the three standards are distinct and the Commission must respect those distinctions.[40/] The details of how the three standards are to be utilized in negotiations and arbitration is a matter that Congress intended the Commission to decide in this proceeding The Commission has a critical role in setting the "rules of the road" for State arbitration of interconnection disputes. Specific national pricing policy facilitates some reasonable degree of uniformity in implementation across the States. Failure to articulate these distinct standards in sufficient detail will hinder the rapid development of competition as new entrants are forced to focus their efforts on resolving the same incumbent LEC cost issues in 50 States rather than building competitive facilities and bringing the benefits of competition to consumers. Cox wholeheartedly agrees with the Notice that the Commission should take the directives of the 1996 Act and provide the States with adequately detailed guidance.[41/]

By the same token, there is no need for the Commission to adopt rules that are so detailed that they preclude any variation from State to State. As described below, Cox proposes that the FCC set floors and ceilings on permissible incumbent LEC pricing that

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39/ 47 U.S.C. § 252(d)(2).

40/ See I.N.S. v. Cardoza-Fonseca, 480 U.S. 421, 430-32 (1987) (agency must conform to Congressional decision to adopt differing standards)

41/ Notice at ¶ 118.

reflect reasonable parameters on interpretation of the 1996 Act's pricing provisions. It further recommends that the Commission adopt specific cost proxies to be used as a default where it is difficult for a State to determine appropriate floor or ceiling costs

The Commission's implementation efforts will prove successful if the Commission adopts an overall framework for the negotiation and arbitration process and sets parameters on acceptable outcomes of arbitrated interconnection disputes. It is critical, however, that this framework be in place very quickly, before arbitration begins. If the Commission fails to articulate a definite but flexible framework for negotiations and to articulate acceptable parameters, it may have to take action after the fact, on a case-by-case basis, to preempt State actions inconsistent with the 1996 Act. Such further delay and uncertainty benefits only the incumbent LECs and not the cause of facilities-based local competition.

The Notice is correct in its conclusion that the 1996 Act and the FCC's statutory duties under Sections 251 and 252 require that the FCC establish the details of cost principles so that the States can uniformly arbitrate disputes and the FCC may review BOC petitions under Section 271.[42/] This conclusion also is consistent with the principle that regulatory agencies are entitled to interpret their basic statutes.[43/]

Cox proposes a framework for cost boundaries that is suggested by the Notice's concept of developing cost ceilings and floors used to determine the rates for the services or functions that must be provided to requesting telecommunications carriers under the 1996 Act

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42/ Notice at ¶ 118.

43/ See Time Warner Entertainment v. FCC, 56 F.3d 151, 174-76 (D.C. Cir. 1995) (affirming Commission interpretation of provisions governing cable rates); see also Chevron, U.S.A., Inc. v NRDC, 467 U.S. 837 (1984).

by incumbent LECs.[44] Under the facilities-based entry models, a separate floor and ceiling for permissible prices is articulated.[45] By using floors and ceilings in this fashion, the FCC can establish absolute boundaries that frame the debate with the incumbent LEC concerning relevant costs and prices during negotiations and, ultimately, arbitration.[46] The Commission also should establish specific cost proxies for the additional costs of transport and termination and for the costs of unbundled elements These proxies should be used when it is difficult for a State to establish an appropriate cost within the boundaries set by the Commission. Such an approach provides uniform guidance for negotiations and to the States, but does not dictate a precise result. A boundary approach preserves to the States their discretion within the arbitration process to choose the best pricing methodology by taking into account the specific conditions and circumstances in each State

1 Cost Boundaries for Transport and Termination. The statutory cost standard for the transport and termination of traffic pursuant to a reciprocal compensation arrangement is plainly a forward looking incremental cost standard with no explicit additional profit element. In return for providing transport and termination to a new entrant, the incumbent LEC receives the reciprocal economic benefit of being able

TRANSPORT AND TERMINATION COST BOUNDARIES

- Forward-Looking Long Run Incremental Cost
- Bill and Keep

44/ Notice at ¶¶ 125, 134.

45/ The 1996 Act "avoided-cost" standard for resale contains no inherently obvious ceiling or floor.

46/ The Commission has correctly recognized that approaches based on ensuring recovery of the incumbent LEC's purported opportunity cost, such as the "efficient component pricing rule," would be inconsistent with the requirement of the 1996 Act and should not be permitted in State arbitration proceedings. Notice at ¶¶ 147-48.

to hand traffic to the new entrant for transport and termination on its facilities.[47] There is an exchange of value under this mutual arrangement, as opposed to the one way lease or sale transaction that takes place when a carrier purchases unbundled elements or purchases retail telephone services for resale.

The statutory pricing scheme reflects the difference between Section 252(d)(1) and (d)(2) by limiting incumbent LEC cost recovery solely to its "additional" cost for transport and termination It is significant that Congress used the term "additional" cost, but also expressly acknowledged that a bill and keep regime (one in which each provider exchanges traffic for termination to the other's customer without charge) can be utilized by the parties or imposed by regulators as a reasonable approximation of these "additional" costs. This suggests that Congress well understood these additional costs to be extremely small. Translating the statutory standard into parameters for negotiation and dispute resolution by the States, Cox submits that the appropriate bounds are forward looking long run incremental cost ("LRIC") on one end and bill and keep on the other.[48]

In advocating LRIC as a parameter, Cox emphasizes that it is not equating LRIC with TSLRIC. While the Notice correctly suggests that, as a matter of economics, LRIC is the appropriate method of reflecting the cost — if any — of interconnection, it asks if LRIC and

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47/ The incumbent LEC also benefits because its customer is able to receive a call from the competitive LEC's customer.

48/ LRIC is the forward looking long run cost of any specific change in output. Here, it refers to the additional cost of the capacity necessary to accommodate a co-carrier's exchanged traffic. See Exhibit 2 (defining economic terms used in these comments); Exhibit 3, Statement of Gerald W. Brock, at 6-7 (describing meaning of "additional cost" in the context of exchange of traffic).

TSLRIC signify the same thing. There are distinctions between LRIC and TSLRIC that lead Cox to conclude that they are, in fact, different standards.

The most significant difference between LRIC and TSLRIC is that TSLRIC studies include *all* of the costs caused by a decision to offer a particular service. TSLRIC may include the total cost for all network parts or functions dedicated to the service as well as the volume sensitive costs of shared network parts or functions and overheads. In contrast, LRIC recognizes only the forward looking incremental costs of specific changes in output. In the case of reciprocal transport and termination, LRIC would recognize the cost of capital expenditures to provide the additional termination and transport required by a competitive LEC, maintenance on those facilities and depreciation on those facilities, without any allocation of overheads.[49/] While each methodology is forward-looking, TSLRIC studies will yield higher costs for individual elements of a service than LRIC.

It is plainly inappropriate for FCC rules or State policies to allow for the recovery of incumbent LEC overhead or common costs in the pricing of reciprocal transport and termination. It is also inappropriate, as the Notice recognizes, to include embedded incumbent network investments.[50/] Despite LEC claims of entitlement to "costs" that include their past network investments, the Notice correctly concludes that forward looking incremental cost is an appropriate place to begin looking for the specific cost of reciprocal

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49/ See Exhibit 2, Exhibit 3 at 6-7

50/ See, e.g., Notice at ¶ 123 (discussing standards under Section 251(d)(1)).

transport and termination under the 1996 Act [51] Indeed, there is no real economic debate that a forward looking LRIC is an economically sound pricing standard for the exchange of local traffic Even BOC economists have advocated in State proceedings the economic efficiency of incremental cost pricing without overheads as a more rational method of interconnection pricing than embedded LEC cost or cost plus pricing.[52]

It particularly makes sense to develop strict reciprocal compensation parameters for State application in light of the presumptions in the statute that favor bill and keep arrangements. While the statute allows recovery of "additional" cost for reciprocal transport and termination, it expressly recognizes bill and keep as a reasonable approximation of these additional costs For this reason, the cost parameters for transport and termination of local traffic should be LRIC and bill and keep. Applying these parameters, States can, as many already have, adopt bill and keep as an interim solution. Alternatively, a State can accept an incumbent's demonstration of its additional cost and, if that cost is no greater than LRIC, select it as the price for reciprocal transport and termination.

The Commission also should adopt bill and keep as the default cost standard for transport and termination when State commissions experience difficulty in determining the

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51/ As Dr. Brock observes in his attached statement, a proxy based on interstate access charges, with their fully distributed cost methodology, various mark ups and subsidy loadings would also be inappropriate for interconnection based on the "additional cost" standard.

52/ See e.g., Comments of SBC Corp., CC Docket No. 95-185 and Attachment A, Testimony of Jerry A. Hausman on behalf of Cellular One, Commonwealth of Massachusetts Department of Public Utilities, D.P.N. 94-185, May, 1995 at 5, 7 ("To promote economic efficiency, network interconnection rates should be set at long-run incremental [marginal costs] .... The Department should indicate its support for the principles of reciprocal compensation and interconnection based on incremental costs.")

appropriate costs for transport and termination As noted above, many States already have adopted bill and keep as an interim compensation mechanism because it is a good approximation of the actual additional costs of transport and termination. Moreover, bill and keep arrangements mimic the results of reciprocal compensation arrangements when traffic is balanced. Finally, it is appropriate to use bill and keep as a default because it will give incumbents LECs better incentives to be forthcoming with information regarding their costs for transport and termination.[53/]

It should come as no surprise that Cox is a proponent of bill and keep for the exchange of traffic by peer networks. Bill and keep is an economically efficient method for interconnection of peer networks that advances the potential for facilities-based competition. As Cox has explained in the CMRS Interconnection proceeding, bill and keep is economically efficient either when traffic exchanged is in approximate balance or the costs for transport and termination (as compared to the cost of measurement and settlements) are extremely low.[54/] Moreover, the Congressional endorsement of bill and keep for the exchange of traffic is a recognition that the connection of local networks on an economic basis is to be encouraged, not discouraged through strategic uneconomic pricing by the incumbent.

53/ "The LECs are generally the ones claiming the right to net payments to them from the parties that interconnect with them. If the interim solution is more favorable to the LECs than the expected negotiated solution, then they will have an incentive to delay the development of data supporting their incremental cost claims." Exhibit 3 at 8.

54/ See Comments of Cox Enterprises, Inc., CC Docket 95-185 (filed Mar. 4, 1996) at 13, citing Gerald W. Brock, "Incremental Cost of Local Usage" (filed in CC Docket No. 94-54, Mar. 21, 1995)

When Congress adopted the 1996 Act, it had the real-world example of adjacent incumbent LECs who overwhelmingly exchange traffic with one another on a bill and keep basis.[55/] The efficiency of this model speaks for itself as the carriers involved do not have to incur additional costs to measure traffic or do net settlements. The Commission should take account of these efficiencies and expressly recognize State arbitrations and review processes that result in bill and keep arrangements for reciprocal local transport and termination as within Section 252(d)(2)'s permissible pricing bounds

In this connection, it also should be noted that there is no basis for distinguishing between the prices paid by adjacent and overlapping local exchange carriers for transport and termination.[56/] The additional cost of reciprocal transport and termination does not vary depending on whether the source of the traffic is an overlapping or adjacent carrier.[57/] The only reason for a LEC to charge an overlapping carrier more for transport and termination than an adjacent carrier would be to discourage competition. Moreover, Congress made no distinction between adjacent and overlapping local exchange carriers in Section 251(b)(5).

55/ One LEC, Ameritech, has used the 1996 Act as an excuse to attempt to renegotiate these arrangements to avoid having to offer bill and keep to new competitors. See Ameritech EAS Move May Alter RBOC-Independent Relationships, STATE TEL. REG. REP., Apr. 18, 1996 at 1

56/ Notice at ¶ 230.

57/ It could be argued that adjacent carriers impose greater costs on incumbent LECs than competing carriers. Every increment of traffic generated by an adjacent carrier is traffic that would not otherwise have traversed the terminating carrier's network. On the other hand, given that incumbent LEC networks already are engineered to carry considerably more than 100 percent of the traffic in their service areas, there will be no additional cost incurred to carry traffic that originates on overlapping competitors' networks until overall usage of local exchange service significantly increases.

2 Cost Boundaries for Unbundled Elements. The pricing standard in Section 252(d)(1) relates to the interconnection and network elements that incumbent LECs are required to provide under Section 251(c)(2). Specifically, incumbent LECs are permitted to price these services "based on the cost . . . of providing the interconnection or network element" which "may include a reasonable profit." This cost plus profit standard reflects the expectation of a recovery of costs and profits on the costs from selling services or leasing facilities to a purchaser.

UNBUNDLED ELEMENT COST BOUNDARIES

- Fully Distributed Cost
- Total Service Long Run Incremental Cost

The Commission should create cost boundaries for unbundled elements that allow States to choose an acceptable pricing result within a range between Total Service Long Run Incremental Cost ("TSLRIC") and Fully Distributed Cost ("FDC").[58/] Using these methods to bracket acceptable results allows the incumbent a price based on cost plus profit, thereby meeting the statutory standard. This relatively flexible boundary allows incumbents to recover overheads, profits and common costs for providing unbundled elements and interconnection for unbundled elements. It also permits some States to determine that recovery of some element of incumbent LEC embedded costs is appropriate, while allowing other States to exclude some or all embedded costs.

A cost plus profit standard for incumbent LEC network elements and interconnection for the provision of those elements is not only required by Section 252(d)(1); it also is consistent with the overall framework of the 1996 Act. In order to provide network

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58/ The definitions of these terms are contained in the glossary of economic terms that is attached hereto as Exhibit 2.

elements, an incumbent LEC is leasing a portion of its network to another carrier to enable that carrier to provide its services. The only benefit the incumbent derives from this relationship is the revenue it receives for the sale of the unbundled element and of the interconnection for use of the unbundled element. It is reasonable to allow the incumbent to recover cost plus profit where the sale of its services or lease of its facilities is the only economic benefit it receives. The cost standard for unbundled elements differs from the standard for reciprocal transport and termination, however, because the latter reflects mutual benefits

Just as for reciprocal transport and termination, the Commission also should adopt a cost proxy to be used by State commissions when it is difficult to determine the appropriate, actual costs for unbundled elements. Any proxy the Commission chooses, such as the Benchmark Cost Model or the Hatfield TSLRIC Study, should permit calculation of the costs of unbundled elements from readily-available data.

It should be noted that the use of different cost standards for reciprocal transport reciprocal and termination and for unbundled elements does not create any risk of arbitrage. As described above, reciprocal transport and termination and particular unbundled elements are distinct from one another and cannot be substituted.[59/] While it is likely that the use of different cost standards will create an incentive for carriers to provide service through their own facilities, that is what Congress intended and is not by any means an accident.

59/ See supra Part II(A). In addition, there will be no unbundled element equivalent to transport and termination, so there will be no opportunity for arbitrage.

3 Pricing for Incumbent LEC Resale. The reciprocal benefit relationship between carriers exchanging traffic is not reflected either in the nature of the relationship between an incumbent LEC and a reseller or in the standards contained in Section 252(d)(3) to define acceptable pricing for resale Resale pricing is governed principally by incumbent LEC retail pricing and not by either the cost-based model used for the leasing of incumbent facilities under Section 252(d)(1) or the arrangements for mutual compensation between co-carriers under Section 252(d)(2). Given the express policy preference in the 1996 Act for the development of facilities-based competition, this is hardly surprising.

RESALE PARAMETERS

- Retail Baseline
- Limited Discounts Imposed on Incumbent LECs

The resale pricing standard for incumbent LECs is their retail service rate less "avoided" costs State regulators are in a position to judge categories of costs LECs can avoid by resale. However, while there is no direct relationship between avoided costs and the standards for unbundled elements and traffic transport and termination, the setting of a margin or discount for resale will have a substantial impact on the build out of facilities that the 1996 Act so plainly prefers. For this reason, Cox suggests that substantial discounts off retail rates are neither achievable under Section 252(d)(3) nor even desirable as a public policy

There also is no need to adopt a default mechanism for pricing resale of incumbent LEC services. There is no readily available proxy that properly accounts for the variations in avoided costs, such as marketing, among various basic and optional incumbent LEC services

C. The Pricing Standards Are Not Cumulative. (Notice Sections II.B.2 and II C.5.)

The three pricing standards contained in Section 252 are not cumulative. A particular service or function provided by an incumbent LEC is governed under one of the three standards, not two or more of the standards. Section 252(d)(1), which governs interconnection and unbundled network elements, applies only when a competing carrier is leasing or purchasing incumbent LEC facilities or services to supplement its own facilities or services — for example, when the competitor provides its own switch and fiber backbone but must interconnect to the incumbent LEC to lease unbundled loops. Section 252(d)(2), by contrast, applies when both carriers originate "local" calls on their network facilities and terminate calls on the other carrier's network pursuant to a reciprocal compensation arrangement that provides for the mutual exchange of traffic. Whether one or both networks are using leased facilities to complete their networks is irrelevant; what matters is that both networks must be capable of originating and terminating traffic to end users. Section 252(d)(3), in turn, applies when the competing carrier simply resells the incumbent LEC's local exchange service. Because what is being provided is distinct, there can be no confusion related to what a new entrant is obligated to pay.

The statute creates no ambiguity on the point of overlap in the Section 251(c)(2) term "interconnection" and the requirement that incumbent LECs establish reciprocal compensation arrangements for the "transport and termination" of local telecommunications under Section 251(b)(5).[60] Interconnection, as used in Section 251(c)(2), refers to the incumbent LEC's duty to provide physical connections to the LEC network of "the facilities and equipment" of the requesting carrier "for the transmission and routing of telephone exchange service and exchange access."[61] The interconnection requirement of Section 251(c)(2) is placed only on incumbent LECs, an acknowledgment that incumbent LECs have stymied potential competitors who must rely on the incumbent to provide interconnection in order to expand their competitive offerings.

The obligation to pay reciprocal compensation for transport and termination of telecommunications, however, applies to all LECs, and is linked directly to the specific pricing standard in Section 252(d)(2) The reason Congress distinguished between interconnection of facilities and transport and termination of traffic is that transport and termination is a reciprocal obligation placed on co-carriers, while interconnection and associated charges for interconnection are intended to be a one-way purchase of network services or lease of network elements with no reciprocal obligation. The requirement that a competing carrier will pay a rate for transport and termination when mutually exchanging traffic with an incumbent that is lower than the rate another carrier pays for use of transport as an unbundled network element reflects this additional reciprocal termination obligation which is imposed only on carriers originating local traffic

60/ Notice at ¶ 54 (indicating that the 1996 Act does not require overlap between Section 251(b)(5) and Section 251(c)(2)).

61/ 47 U.S.C. § 251(c)(2).

This non-cumulative, "carrier only pays once for what it uses" approach makes sense. If, for example, an interexchange carrier purchases unbundled elements to build its local network, it will pay the incumbent for interconnection and network elements under Section 252(d)(1) for those services. Once the interexchange carrier has paid the incumbent for the network elements and associated interconnection, it is entitled to termination and transport of its local traffic from the incumbent under the pricing standards of Section 252(d)(2). Under this approach, there is no possibility that the lines between resale, network elements and transport and termination will blur or, as discussed above, that an arbitrage problem will be created.

This approach also will ease administration of the requirements of Section 251. Maintaining distinct boundaries between reciprocal transport and termination under Section 251(b)(5) and the purchase of unbundled elements under Section 251(c) will greatly reduce the potential for confusion by incumbent LECs and other carriers as they undertake negotiations and arbitrations under Section 252. If the Commission blurred the boundary between Section 251(b)(5) and Section 251(c), contrary to the statute's language and Congressional intent, then there would be a significant potential for disputes between incumbent LECs and new entrants regarding whether new entrants would be required to purchase specific unbundled elements (and which elements would have to be purchased) to reciprocal obtain transport and termination. At the same time, permitting carriers to obtain what they need (whether simply transport and termination, resale or a combination of unbundled elements and transport and termination) will simplify the process of entering the local telephone marketplace, to the benefit of both new entrants and consumers.